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RUEHBJ/AMEMBASSY BEIJING 0261  
RUEHKO/AMEMBASSY TOKYO 0971  
RUEAIIA/CIA WASHDC  
RHEFAAA/DIA WASHDC  
RHEHNSC/NSC WASHDC 0429  
RUEKJCS/SECDEF WASHDC 0344  
RUCPDO/DEPT OF COMMERCE WASHDC  
RHEBAAA/DEPT OF ENERGY WASHDC  
RUEATRS/DEPT OF TREASURY WASHDC  
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SUBJECT: KAZAKHSTAN: GOVERNMENT MOVES SWIFTLY TO STABILIZE BANKING  
SECTOR (PART 3 OF 3)

REF: A) 08 ASTANA 2320 B) 08 ASTANA 2338

11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: On October 13, 2008, President Nazarbayev announced a series of sweeping measures to be enacted by the Government of Kazakhstan in response to the global financial crisis. Established to ensure the stability of Kazakhstani financial markets, these measures include the accelerated establishment and implementation of the Asset Stabilization Fund (ASF), the merger of the two largest asset generating and wealth distributing state holding companies Samruk and Kazyna, the Law on Financial Stability (since adopted), and the government's intention to purchase 25% equity stakes of the leading four banks sometime in the coming months. Created in response to the deteriorating quality of bank credit portfolios, the ASF (formerly known as the distressed asset fund) is likely to be used to purchase collateralized distressed mortgages at a 10 percent discount, while shunning assets classified as "hopeless" by the national financial regulator. The total share of non-performing loans (NPL) in the banking sector is unclear, with estimates ranging from the low single digits to as high as 20 percent. As a result of the crisis, local banks have begun to revamp their lending practices and bolster their risk management strategies. END SUMMARY.

ASSET STABILIZATION FUND LAUNCH EXPECTED EARLY 2009

13. (SBU) The government's purchase of shares in major local banks follows the creation of the Asset Stabilization Fund in October. First announced in July 2007 as a possible Stressed Asset Fund, the program was subsequently renamed the Asset Stabilization Fund (ASF). While the injection of capital and acquisition of bank shares remain the top priority at this time, the government recognizes a growing need to launch this fund in conjunction with broader economic stabilization measures. Both Citibank and the World Bank are advising the government on the creation of the fund. Unfortunately, official details have yet to be released and could not be solicited from Citibank because of confidentiality agreements. However, it is widely expected that the fund will purchase distressed assets in the form of loans and bad mortgages,

including complete construction projects.

#### RAPID STEPS TOWARD IMPLEMENTATION

14. (SBU) According to Citibank-Kazakhstan CEO Dan Connelly, the government is under considerable pressure to move forward quickly. During a November 7 meeting with Prime Minister Masimov, Finance Minister Bolat Zhamishev, Samruk-Kazyna Director Kairat Kelimbetov, Connelly noted that Zhamishev had a "lot of good questions and clearly understood the seriousness of the current crisis." Most expect the Fund to be launched in early 2009, which in the words of the Head of Risk Management at ATF/Uni Credit, Nurlan Akshanov, will by then "already be necessary."

#### ONLY PROFITABLE ASSETS TO BE PURCHASED

15. (SBU) The government is expected to purchase distressed assets at a 10 percent discount. The government is also expected to limit its purchases to collateral-based assets from categories 3 and 4 (of the 5 categories designated by the Financial Supervision Agency or FSA) -- 5 being "hopeless" -- in an effort to ensure that losses will be recouped through a later sale of the assets. Truly "toxic" assets (category 5) will not be purchased. The most recent public announcements estimate the fund's capitalization at 52 billion Tenge (or approximately \$430 million), which Citibank representatives assure us is a fluid figure used primarily for planning purposes. As with other planned financial measures, the fund will be managed by Samruk-Kazyna. National Bank Deputy Governor Sartbayev expects money to be transferred to the fund by the end of the year. Overall, the fund is expected to remain in existence for five to seven years.

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#### ASSET QUALITY UNCLEAR

16. (SBU) One of the greatest unknowns within the Kazakhstani financial industry remains the true scale of the crisis facing the credit market. This is largely the result of different definitions and categories used by banks, regulatory, and monitoring agencies to classify and report varying degrees of bad debt. Without a clear picture, it is difficult to assess the efficacy of the government's stabilization efforts. The numbers and percentages of bad debt (also known as impaired assets or non-performing loans) remain widely disputed across the industry. Individually, the top four banks each report very small percentages of their loan asset portfolios to be non-performing loans (NPL). This reporting does not reflect the severity of the situation as evidenced by the government's response.

#### NON-PERFORMING LOANS EXPECTED TO INCREASE

17. (SBU) Industry analysts agree that the most rapid growth in NPL occurred in the retail sector, or consumer credit accounts, but more recently NPL growth has been detected in a wider range of investments, including corporate loans and mortgages. Several top Kazakhstani banks shared their percentage of non-performing loans with Econoff, including BTA (1.8%, but expected to grow as high as 3.0%), KazKommertsBank (5.0%), Halyk Bank (7.0%), ATF/UniCredit (4.6%), and BCC (2.3%, with expectations that it will rise as high as 4.0%). (NOTE: BTA is slated to receive by far the largest injection of capital, yet reports the smallest percentage of NPL. END NOTE). Kazakhstani government officials report somewhat higher calculations for the industry as a whole. According to the FSA, approximately 6-7% of the total loan portfolio should be classified as NPL. However, Kazyna General Manager Marat Aitenov reports that FSA category 5 ("hopeless") loans are 10% of the banking industry's total portfolio. Regardless of these discrepancies, EBRD Senior Banker Ulf Hindstrom is confident that the Kazakhstani government, including the FSA, has "significantly underestimated the percentage of bad loans," a belief corroborated by Standard and Poor's November 18 estimate that "loans under stress" comprise 20% of the Kazakhstani banking portfolio.

#### BANKS BRACING FOR CRISIS

18. (SBU) Local banks have taken urgent measures to recalibrate lending practices, shore up risk management strategies, and provision existing stressed assets. Their efforts have been facilitated by recent decisions made by the FSA and National Bank of Kazakhstan to reduce reserve requirements, which will in turn raise available liquidity levels and enable banks to continue lending. According to the EBRD, risk management is a relatively new concept for most of these banks, where previous levels of economic growth across Kazakhstan permitted aggressive growth strategies. ATF/Uni Credit, for example, recently created a 34-member security department headed by a former official from the Ministry of Internal Affairs to manage bad credit. Kazakhstani banks are also working to shift their loan portfolios away from the more volatile construction and real estate industries toward corporate lending and support for SMEs. Representatives at KazKommertsBank (KKB) said that their primary challenges in the near term will be to identify credit risks, categorize loans, and evaluate survivability.

19. (SBU) COMMENT: The government's quick steps to capitalize and activate the ASF underscore the growing sense of urgency for action felt throughout the Kazakhstani financial sector. As with crisis relief efforts elsewhere, the greatest unknown remains the undetermined scope of the crisis. Only time will tell if the government's rapid and direct involvement in the economy will be enough to avert disaster. END COMMENT.

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